



## Testimony

Before the Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia, Committee on Governmental Affairs, U.S. Senate

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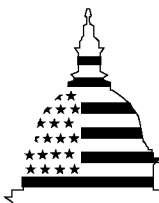
# HUMAN CAPITAL

## Major Human Capital Challenges at SEC and Key Trade Agencies

Statement of

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Accountability \* Integrity \* Reliability

## Report Documentation Page

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<b>Abstract</b> We appreciate the opportunity to appear here today to discuss the human capital challenges facing the agencies that play key roles in monitoring publicly traded companies and enforcing our nations trade laws. As you are aware, GAO has been a leading promoter of a more strategic approach to federal human capital issues. We are particularly gratified to come before this subcommittee, as you have been committed advocates of our efforts, sponsoring much of our work in this area. The leadership provided by this subcommittee and the Senate Committee on Governmental Affairs has been especially important in focusing attention on the federal governments human capital challenges.		
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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to appear here today to discuss the human capital challenges facing the agencies that play key roles in monitoring publicly traded companies and enforcing our nation's trade laws. As you are aware, GAO has been a leading promoter of a more strategic approach to federal human capital issues. We are particularly gratified to come before this subcommittee, as you have been committed advocates of our efforts, sponsoring much of our work in this area. The leadership provided by this subcommittee and the Senate Committee on Governmental Affairs has been especially important in focusing attention on the federal government's human capital challenges.

Over the past 2 years, our work in the major management challenges and program risks across the government has identified human capital as a primary factor affecting current and future agency performance. In fact, in January 2001, GAO designated strategic human capital management as a governmentwide high-risk area.<sup>1</sup> As our 2001 *High-Risk Series* and *Performance and Accountability Series* reports make clear, serious human capital shortfalls are eroding or threatening to erode the ability of many agencies to effectively perform their missions.<sup>2</sup> We found that many agencies lack a consistent strategic approach to marshaling, managing, and maintaining the human capital needed to maximize performance and ensure accountability. Today we will discuss the specific challenges faced by the Securities and Exchange Commission (SEC), whose mission is to protect investors and the integrity of securities markets, which includes overseeing public companies. We will also discuss the Department of Commerce, the Office of the U.S. Trade Representative (USTR), and the U.S. Department of Agriculture--the key agencies that monitor and enforce our nation's trade agreements.

Although these agencies have diverse responsibilities, our statement today will address the specific human capital challenges these agencies face. Specifically, this statement provides information on (1) workload and staffing challenges, (2) the effects of workload and staffing imbalances on the agencies' ability to fulfill their missions, and (3) other factors that affect the fulfillment of these agencies' respective missions. Our observations about the challenges faced by SEC and the key trade agencies are based on three reports issued between 2000 and 2002.<sup>3</sup> In addition, we updated our previous work through a series of meetings with appropriate agency officials. This statement was completed in accordance with generally accepted government auditing standards.

In summary, our work at these agencies has resulted in reports that address the human capital challenges faced by SEC and the key trade agencies. In our 2002 report on SEC, we found that SEC faces a workload that is growing at a rate much faster than staffing in an environment where

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<sup>1</sup> See U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-01-263 (Washington, D.C.: Jan. 2001).

<sup>2</sup> U.S. General Accounting Office, *Performance and Accountability Series—Major Management Challenges and Program Risks: A Governmentwide Perspective*, GAO-01-241 (Washington, D.C.: Jan. 2001). In addition, see the accompanying 21 reports (numbered GAO-01-242 through GAO-01-262) on specific agencies.

<sup>3</sup> See U.S. General Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, GAO-02-302 (Washington D.C.: Mar. 5, 2002); *International Trade: Strategy Needed to Better Monitor and Enforce Trade Agreements*, GAO/NSIAD-00-76 (Washington, D.C.: Mar.14, 2000); and *Securities and Exchange Commission: Human Capital Challenges Require Management Attention*, GAO-01-947 (Washington D.C.: Sept.17, 2001).

markets have become more complex, global, and technology-driven. We found that workload and staffing imbalances have affected most aspects of SEC's regulatory and supervisory activities, from its inhouse technological capabilities to its ability to take enforcement actions against market participants. SEC also faces challenges beyond its resource limitations. For example in our 2001 and 2002 reports on SEC, we discussed the high staff turnover, which hampers its effectiveness and efficiency, and a strategic planning process that has not included a strategic reevaluation of programs and activities in light of current and emerging challenges.

We also found that the key agencies that monitor U.S. trade agreements faced human capital challenges. As we reported in March 2000, since the early 1980s, the United States has entered into several hundred trade agreements, which has caused dramatic increases in the trade monitoring and enforcement workloads at USTR, Commerce, and Agriculture. This workload has continued to grow over the past 2 years as a result of such factors as the launch of major multilateral, regional, and bilateral trade negotiations. In our 2000 report, we found that these agencies' efforts to monitor and enforce trade agreements were hampered because they lacked sufficient staff with appropriate expertise, did not receive adequate support from other agencies, and had difficulty obtaining comprehensive input from the private sector. We found that since our report was issued, staffing for trade compliance efforts has increased at all three agencies, but we believe it is too early to predict the impact of these increases. Moreover, the agencies face other human capital challenges, including problems with recruitment and high turnover rates.

### **Human Capital Issues at SEC Threaten Its Ability to Fulfill Its Mission**

Over the last decade, securities markets have experienced unprecedented growth and change. Moreover, technology has fundamentally changed the way markets operate and how investors access markets. These changes have made the markets more complex. In addition, the markets have become more international, and legislative changes have resulted in a regulatory framework that requires increased coordination among financial regulators and requires that SEC regulate a greater range of products and participants. Moreover, the recent sudden collapse of Enron and other corporate failures have stimulated an intense debate on the need for broad-based reform in such areas as financial reporting and accounting standards, oversight of the accounting profession, and corporate governance, all of which could have significant repercussions on SEC's role and oversight challenges. At the same time, SEC has been faced with an ever-increasing workload and ongoing human capital challenges, most notably high staff turnover and numerous vacancies.

### **SEC Faces Significant Workload and Staff Challenges**

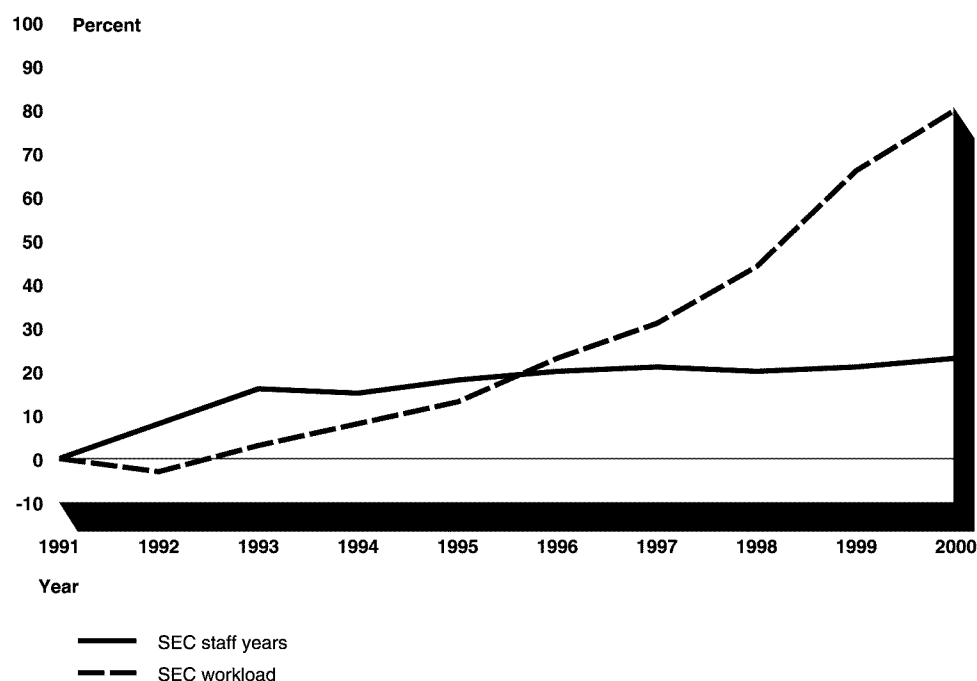
As stated in our March 2002 report, we found that SEC's ability to fulfill its mission has become increasingly strained due in part to imbalances between workload and staff resources.<sup>4</sup> As illustrated in figure 1, the larger, more active, and more complex markets just discussed have

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<sup>4</sup> Staff resources are measured in terms of full-time equivalent staff years.

resulted in an increased aggregate workload (e.g., filings, complaints, inquiries, investigations, examinations, and inspections) for SEC. As the dotted line indicates, SEC's workload has continued to grow at a rapid rate throughout the decade while staff resources, represented by the solid line, have grown little. As a result, SEC has been challenged to keep up with its increasing workload since about 1996.<sup>5</sup>

**Figure 1: Percent Change in SEC Staff Years and Workload, 1991-2000**



Source: GAO analysis of SEC data.

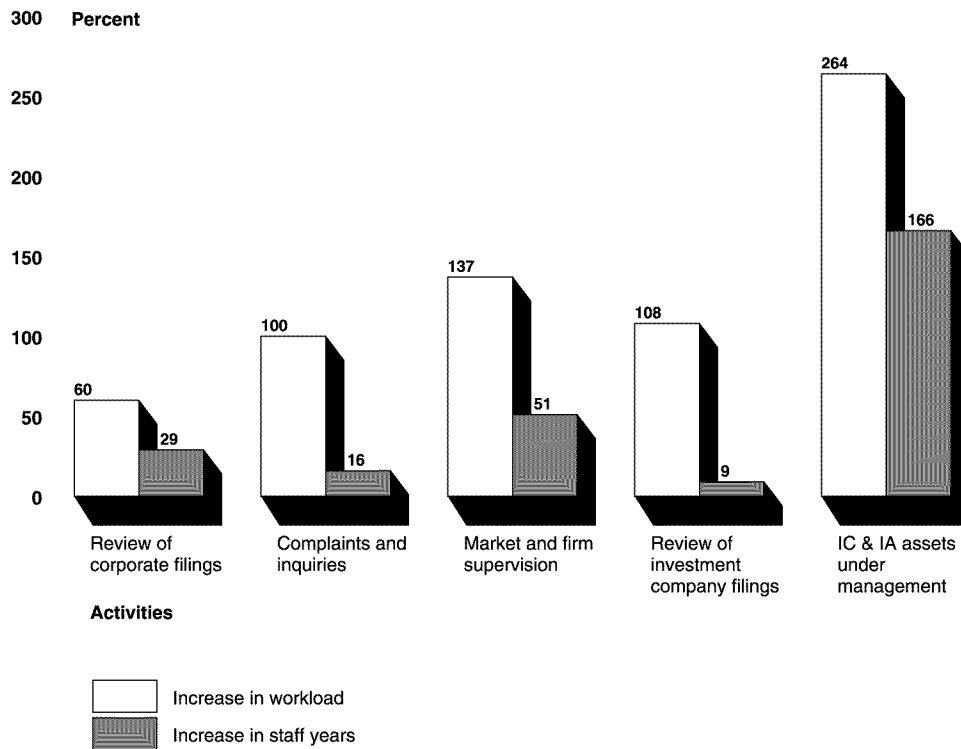
When we reviewed this workload on an activity basis, we found that over the last decade staffing within the various areas of SEC's regulatory oversight grew between 9 and 166 percent, while workload in those same areas grew from 60 to 264 percent. As figure 2 illustrates, these disparities exist across all key SEC activities, as the increase in SEC's workload has substantially outpaced the increases in SEC's staff. For example,

- the number of corporate filings increased almost 60 percent, while related review staff increased 29 percent;
- the number of complaints and inquiries received increased by 100 percent, while the enforcement staff dedicated to investigate complaints and other matters increased by only 16 percent;

<sup>5</sup> All years are fiscal years unless otherwise noted.

- the number of market and firm supervision actions increased 137 percent, but the number of staff responsible for these activities increased 51 percent;<sup>6</sup>
- investment company filings increased 108 percent while staff increased 9 percent; and
- total assets under management by investment companies (IC) and investment advisers (IA) increased by about 264 percent, while the number of IC and IA examination staff increased by 166 percent.

**Figure 2: Percent Change in Workload and Staff Years for Selected SEC Activities, 1991-2000**



Source: GAO analysis of SEC data.

### SEC's Ability to Fulfill Its Mission Has Become Increasingly Strained

In our work at SEC, we found that its ability to fulfill its mission has become increasingly strained due in part to imbalances between SEC's workload (such as filing, complaints, inquiries, investigations, examinations, and inspections) and staff resources (full-time equivalent [FTE] staff years). Although industry officials complimented SEC's regulation of the industry given its staff size and budget, both SEC and industry officials identified several challenges that SEC faces. First, resource constraints have contributed to substantial delays in the turnaround time for many SEC regulatory and oversight activities such as approvals for rule filings and exemptive

<sup>6</sup> Market and firm supervision actions include: self-regulatory organization and SEC rule proposals; interpretive guidance and exemptive applications; analyses of proposed enforcement actions, disclosure documents, and risk assessment reports; automated trading system analyses and automation reviews of self-regulatory organization systems; policy papers; Congressional, governmental, industry, and public correspondence; and other reports and analyses of SEC's Division of Market Regulation.

applications.<sup>7</sup> According to industry officials, such delays have resulted in forgone revenue and have hampered market innovation. Second, resource constraints have contributed to bottlenecks in the examination and inspection area as SEC's workload has grown. As a result, certain examinations and inspections take longer to complete. Third, limited resources have forced SEC to be selective in its enforcement activities and have lengthened the time required to complete certain enforcement investigations.<sup>8</sup> Fourth, SEC staff have reviewed certain filings less frequently and completely as workloads increased. Fifth, today's technology-driven markets have created ongoing budgetary and staff challenges. Finally, SEC and industry officials said that SEC has been increasingly challenged in addressing emerging issues, such as the ongoing internationalization of securities markets and technology-driven innovations like alternative trading systems<sup>9</sup> and exchange-traded funds. Although we address the implications of all of these challenges in our 2002 report, today we will focus our discussion on two critical aspects of SEC's operations—its reviews of corporate filings and enforcement activities.

#### Certain Financial Statement and Other Filings Are Subject to Less Frequent Review by SEC Staff

Like other aspects of SEC's workload, the number of corporate filings has grown at an unprecedented rate. For example, from 1991 to 2000, the number of corporate filings increased 60 percent. During this same period, the percent of all corporate filings that received some type of review by SEC decreased from about 21 percent to 8 percent.<sup>10</sup> We found that SEC's 2001 goal was to complete a full financial review of each issuer's annual filings in 1 of every 3 years—a review goal of about 30 to 35 percent of annual filings per year. According to SEC, this level of review was expected to “ensure that material issues are disclosed clearly and completely and that possible fraudulent activities are addressed promptly.” However, in 2001, SEC completed full or full financial reviews of only 16 percent of the annual reports filed or about half of its annual goal.

In November 2001, the Division of Corporation Finance announced that staffing levels were expected to remain flat while filings were expected to continue to increase in number and complexity. In this post-Enron environment, SEC plans to reconsider how it will select filings for review and how it will review the filings selected. Rather than conducting full reviews of fewer firms, SEC officials said SEC may limit its review to a specific disclosure issue and

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<sup>7</sup> A company files an exemptive application when it seeks an SEC decision to exempt a new activity from existing rules and laws.

<sup>8</sup> The SEC chairman has recently announced an initiative called real-time enforcement, which is intended to protect investors by (1) obtaining emergency relief in federal court to stop illegal conduct expeditiously; (2) filing enforcement actions more quickly, thereby compelling disclosure of questionable conduct so that the public can make informed investment decisions; (3) deterring future misconduct through imposing swift and stiff sanctions on those who commit egregious frauds, repeatedly abuse investor trust, or attempt to impede the SEC's investigatory processes. According to the SEC, insufficient resources may inhibit the effectiveness of this initiative, which depends upon prompt action by enforcement staff.

<sup>9</sup> An alternative trading system is an entity that performs the functions commonly performed by a stock exchange.

<sup>10</sup> SEC's review of corporate filings may involve a full review, a full financial review, or monitoring for specific disclosure items. A full review involves an in-depth examination of the accounting, financial, and legal aspects of an issuer's filing. A full financial review involves an in-depth accounting analysis of an issuer's financial statements and management's discussion and analysis or business plan disclosure.

review more filings for that issue. For example, SEC may choose to focus on off-balance sheet activities and work with the companies to improve disclosure. However, SEC officials said that full reviews will not be completely abandoned, but the revised approach should help SEC better deploy limited staff resources and enable it to have a greater review presence across all types of corporate filings in the future. Further, in December 2001, in response to the disclosure and accounting problems of Enron, SEC began to review the annual filings of the 500 largest U.S. companies.

### Workload Growth and Limited Staffing Raise Concerns about Enforcement

In the 2002 report, we also reported that delays in closing cases and a growing backlog of smaller investigations presented ongoing challenges for SEC. Over the past decade, SEC's Division of Enforcement staff devoted to investigations increased 16 percent to about 482 staff years, while the number of cases opened increased 65 percent to 558. Although increased staff has allowed more work to be initiated, delays in completion of individual cases persist. Moreover, the number of cases pending at the end of the year increased 77 percent over this same time period. SEC officials said the increase in the number of cases pending was due in part to high staff turnover, which has resulted in old cases not being closed or ongoing cases being delayed until other staff can take over. For example, SEC officials reported that in 2000 alone, over 58 experienced staff left the division.

As this subcommittee recognizes, enforcement activities are important for carrying out SEC's mandate to protect investors and deter fraud and abuse. Because SEC has limited resources and cannot prosecute every case, SEC officials said they must prioritize the cases they will pursue. According to SEC officials, SEC generally prioritizes the cases in terms of (1) the message delivered to the industry and public about the reach of SEC's enforcement efforts, (2) the amount of investor harm done, (3) the deterrent value of the action, and (4) SEC's visibility in certain areas such as insider trading and financial fraud. Except for the length of time taken to complete an investigation, most industry officials said that SEC was effective in this area. Although SEC data show that the average length of time to complete an investigation has decreased, we did not perform a detailed review of the individual investigations to determine whether this was an improvement or whether SEC on average pursued less time-consuming matters for investigation.

### SEC Faces Other Human Capital Challenges

In addition to the staff and workload imbalances, other factors also contribute to the challenges SEC currently faces. SEC officials said that although additional resources could help SEC do more, additional resources alone would not help SEC address its high turnover, which continues to be a challenge for the agency. As we discussed in our 2001 report on SEC's human capital practices, about one-third of SEC's staff left the agency from 1998 to 2000.<sup>11</sup> By 2001, this

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<sup>11</sup> GAO-01-947.

number had increased to 40 percent. SEC's turnover rate for attorneys, accountants, and examiners averaged 15 percent in 2000, more than twice the rate for comparable positions governmentwide. Although the rate had decreased to 9 percent in 2001, turnover at SEC was still higher than the rate governmentwide. Further, because of its high turnover and inability to hire new staff quickly, about 250 positions remained unfilled in September 2001, which represents about 8.5 percent of SEC's authorized positions. Likewise, industry officials agreed that many of the challenges SEC faces today are exacerbated by its high turnover rate, which results in more inexperienced staff and slower, often less efficient, regulatory processes.

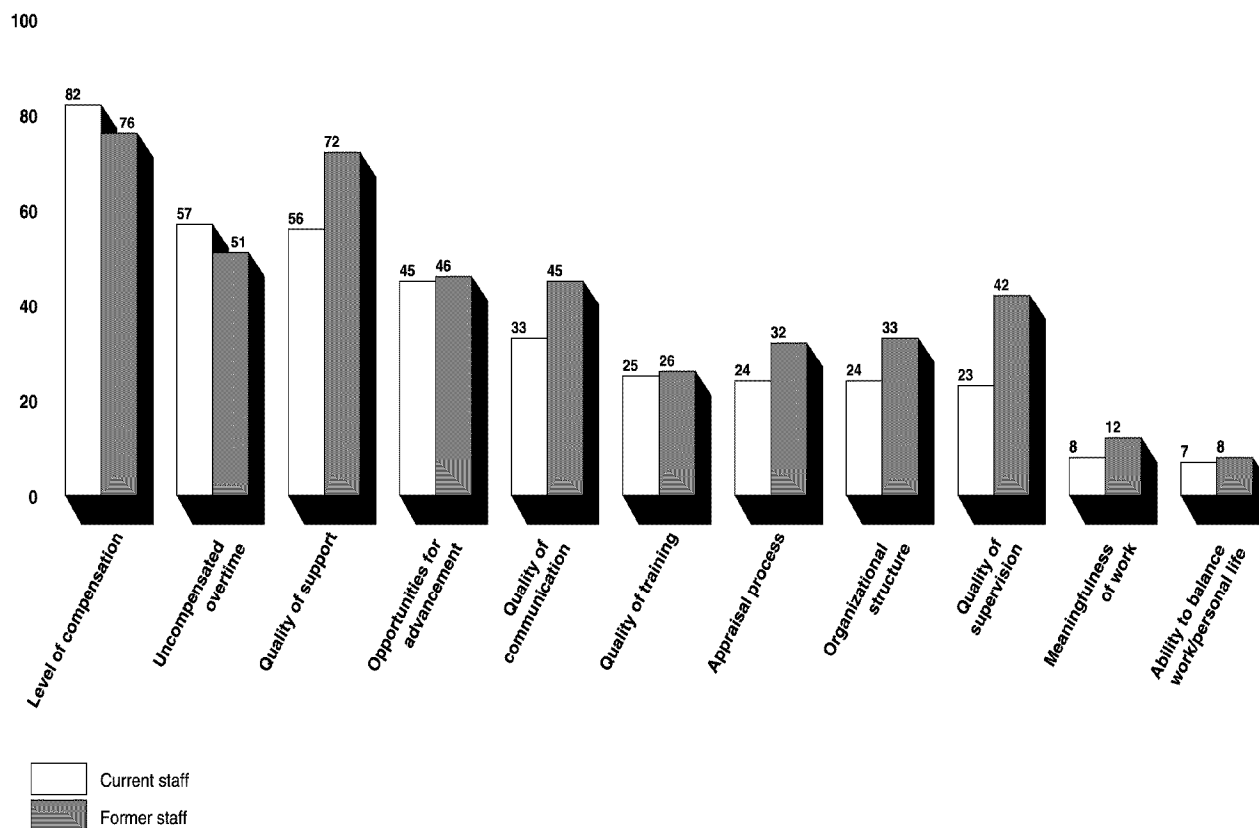
SEC and industry officials alike recognize that SEC will always have a certain amount of turnover because staff can significantly increase their salaries in the private sector, and some staff plan to stay at SEC for only a limited period of time. Many officials said pay parity with other financial regulators could enable SEC to attract and retain staff for a few additional years. SEC estimates that a new employee generally takes about 2 years to become fully productive; in some divisions, junior staff were staying 2 years on average. We found that from 1992 to 1999, the average tenure of an examiner decreased from 2.9 to 1.9 years and the average tenure for attorneys leaving SEC had decreased from 3.4 years to 2.5 years. Moreover in 2000, 76 percent of SEC examiners had been with the agency less than 3 years.

We explored the reasons for SEC's high turnover among its professional ranks and actions taken to address this problem in our 2001 human capital report.<sup>12</sup> To do this, we surveyed current and former SEC attorneys, accountants, and examiners to determine why they had left or would consider leaving SEC. Overwhelmingly, compensation was cited as the primary reason for leaving SEC. However, respondents also identified other nonpay factors that had affected or would affect their decisions to leave, such as the lack of opportunities for advancement, the amount of uncompensated overtime, and the quality of administrative support. As illustrated in figure 3, these factors also had a generally or very negative effect on morale. This graphic also illustrates that 20 percent or more of current staff identified other aspects of work at SEC that could negatively affect staff morale, including the quality of communication, training, and supervision; the appraisal process; and the organizational structure. Among other things, in our 2001 report we recommended that the chairman SEC identify ways to involve human capital leaders in decision making and establish a practice that requires management to continually monitor and refine SEC's human capital approaches to ensure their ongoing effectiveness.

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<sup>12</sup> GAO-01-947.

**Figure 3: Percentage of Staff Indicating Certain Aspects of Their Job Had a Generally or Very Negative Effect on Morale**



Source: GAO survey of current and former SEC attorneys, accountants, and examiners.

Although SEC has taken numerous actions to address its high turnover including use of special pay rates and retention bonuses, its turnover rate remains higher than the governmentwide rate. The compensation challenges that SEC faces are indicative of the pay issues that some other agencies face as well, and underscore the need to consider governmentwide pay reform that needs to make a more direct link between pay and individual knowledge, skills, abilities, and performance.

Aside from special pay rates for certain professional staff, SEC employees are paid according to general government pay rates. However, on January 16, 2002, legislation was enacted that exempted SEC from federal pay restrictions and provided it with the authority necessary to bring salaries in line with those of other federal financial regulators, but to date SEC has not received any additional appropriations to fund higher salaries. SEC estimates that an additional \$76 million is needed to provide pay parity for the agency in 2003. For 2003, SEC also is seeking from its congressional appropriators an additional 100 staff positions. It requested 30 accountants, lawyers, and other professionals in the Division of Corporation Finance to enhance its capability to review periodic disclosure filings of public companies. It requested 35 accountants and lawyers in the Division of Enforcement to deal with an increasing workload of financial fraud and reporting enforcement cases. It also requested 35 accountants, lawyers, and other professionals in other divisions including the Office of the Chief Accountant—to deal with

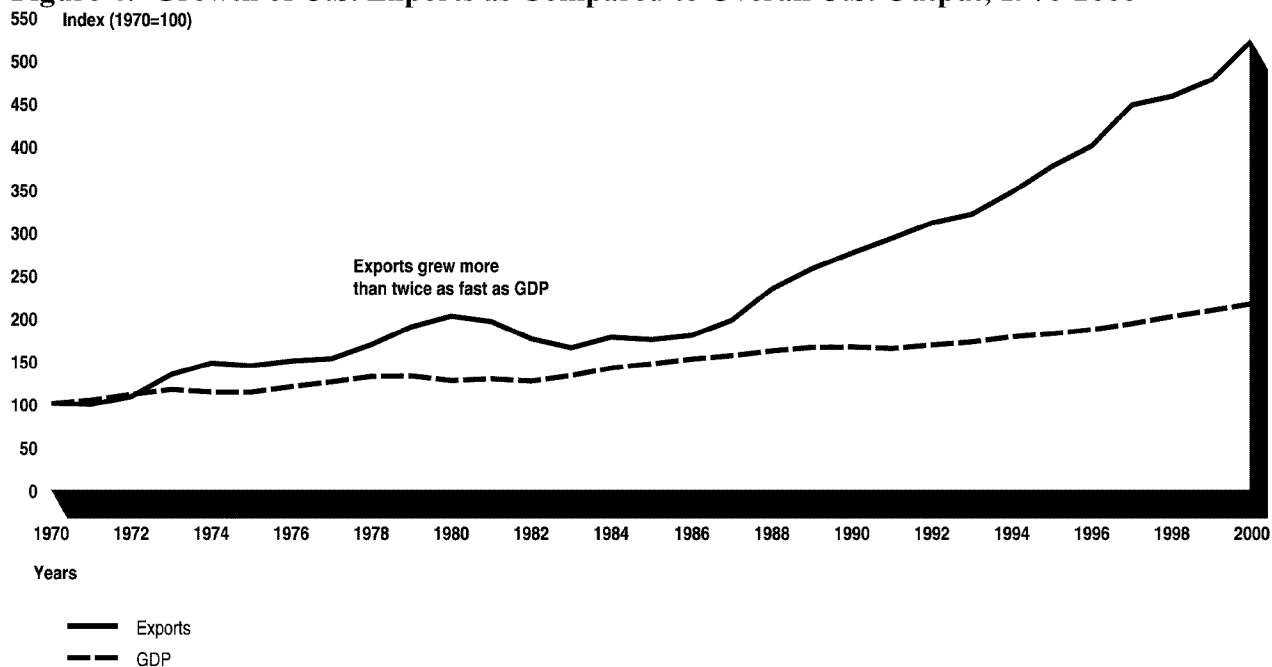
evolving needs and policy development. Without these requested increases for pay parity and additional staff, SEC says that it will continue to be restrained from retaining and attracting experienced staff and from fully addressing the new regulatory challenges and growth of workload that it faces.

Although SEC's workload and staffing imbalances have challenged SEC's ability to protect investors and maintain the integrity of securities markets, SEC has generally managed the gap between workload and staff by determining what basic, statutorily mandated duties it could accomplish with existing resource levels. This approach, while practical, has forced SEC's activities to be largely reactive rather than proactive. For instance, SEC has not put mechanisms in place to identify what it must do to address emerging and evolving issues. Although SEC has a strategic plan and has periodically adjusted staffing or program priorities to fulfill basic obligations, SEC has not engaged in a much needed, systematic reevaluation of its programs and activities in light of current and emerging challenges. Given the regulatory pressures facing SEC and its ongoing human capital challenges, it is clear that SEC could benefit from some additional funding. However, a comprehensive, agencywide planning effort, including planning for use of technology to leverage available resources, could help SEC better determine the optimum human capital and funding needed to fulfill its mission. On March 20, 2002, SEC announced that it had undertaken a special study of the agency's operations and resources intended, in part, to implement a recommendation in our report.

### **Commerce and Other Agencies that Oversee Trade Agreements Face Human Capital Challenges**

Trade's influence on the U.S. economy has increased dramatically over the past decade, with exports growing more than twice as fast as U.S. output (figure 4). Most of the growing volume of U.S. exports is governed by the terms of trade agreements. U.S. government efforts to monitor and enforce these agreements involve at least 17 federal agencies, with three key agencies, USTR and the Departments of Commerce and Agriculture, having significant roles.

**Figure 4: Growth of U.S. Exports as Compared to Overall U.S. Output, 1970-2000**



Source: GAO calculation based on IMF data.

In March 2000, we reported that the creation of a vast array of U.S. trade agreements since the early 1980s had caused dramatic increases in the trade monitoring and enforcement workloads at USTR, Commerce, and Agriculture. Further, we found that these agencies' ability to monitor and enforce trade agreements was limited due to a lack of sufficient staff with appropriate expertise, inadequate support from other agencies, and difficulty obtaining comprehensive input from the private sector. Since our report was issued, staffing for trade compliance activities has increased at all three agencies, although the impact of these increases is uncertain. Moreover, the agencies face other human capital challenges, such as problems with recruitment and high turnover rates.

### Trade Agencies Face Workload and Staffing Challenges

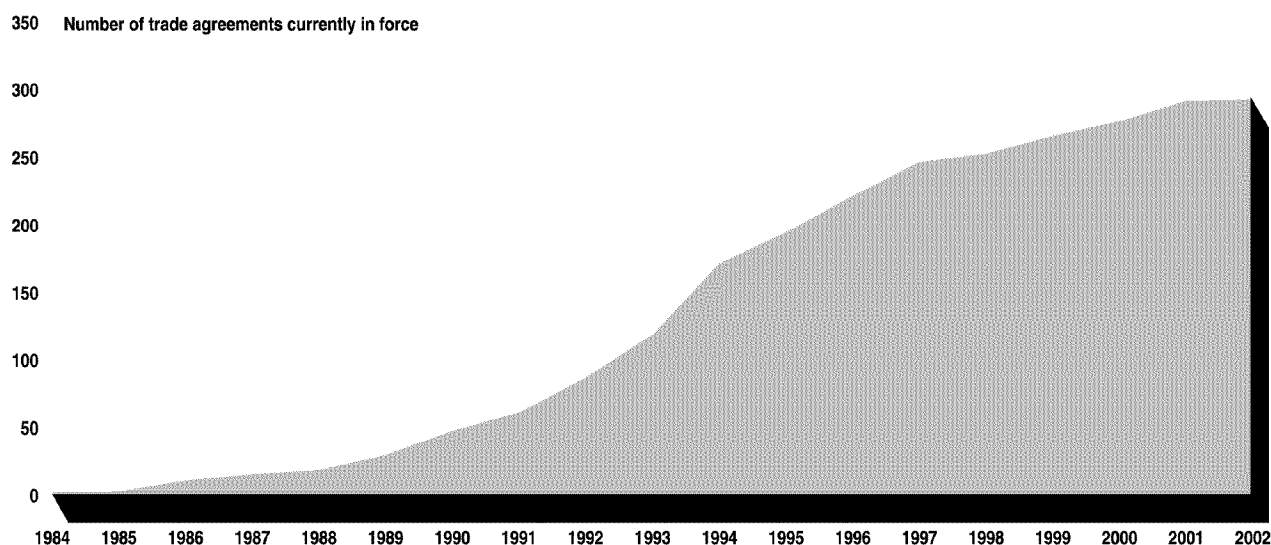
USTR's, Commerce's, and Agriculture's trade monitoring and enforcement workload has increased substantially in the last few years. While the number of staff performing these functions at the three agencies has also increased, their workload continues to grow in volume and complexity. Therefore, human capital challenges remain. Some important reasons for the growing workload include the rising number of U.S. trade agreements, the increasing number of countries that are party to these agreements, and the growing number of active trade disputes involving the United States.

#### Agencies' Workload Is Increasing in Volume and Complexity

In recent years, the number of trade agreements has grown substantially. Since the early 1980s, the United States has entered into more than 400 trade-related agreements. USTR negotiated

about 300 of these, over 70 percent of which entered into force after 1992. According to USTR, the majority of these agreements have increased U.S. exporters' access to foreign markets. Figure 5 depicts the growth in the number of trade agreements that USTR negotiated since 1984.

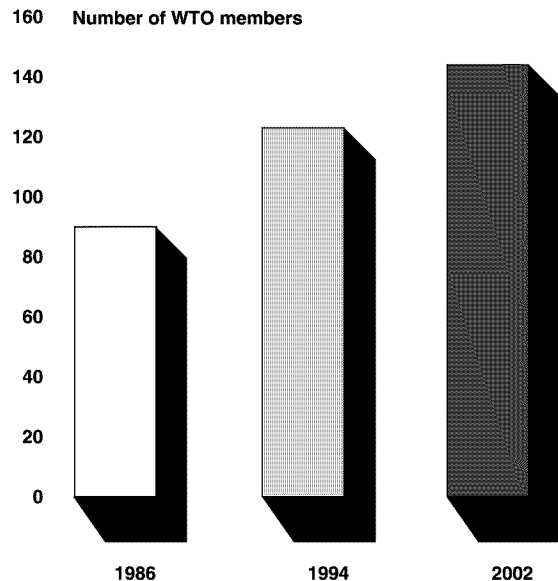
**Figure 5: Number of USTR-Negotiated Trade Agreements in Force, 1984-2002**



Source: USTR, 2001 Trade Policy Agenda and 2001 Annual Report.

At the same time, the number of nations that participate in key trade agreements has grown, further expanding the federal monitoring and enforcement workload. For example, when the Uruguay Round of multilateral trade negotiations was launched in 1986, 90 countries were members of the General Agreement on Tariffs and Trade, the organizational structure that preceded the World Trade Organization (WTO). By the time that the WTO agreements were signed in 1994, the number of WTO members had expanded to 123. An additional 21 countries have joined the WTO since then, including China. China's WTO membership, in particular, will increase the agencies' monitoring and enforcement workload given that the terms of its accession are extremely complex, totaling about 1000 pages. Figure 6 depicts the growth in WTO membership since 1986.

**Figure 6: World Trade Organization Membership, 1986-2002**

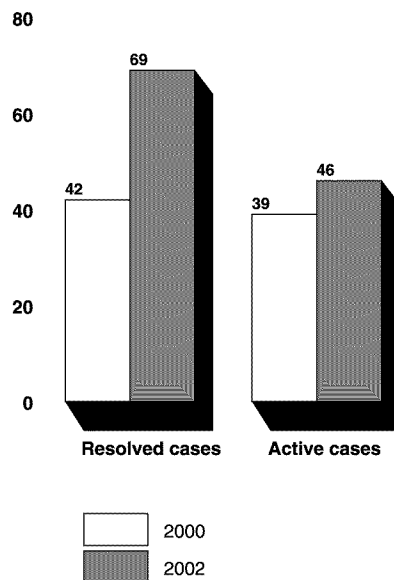


Sources: Data for 1986 and 1994 from GAO/NSIAD-00-76. Data for 2002 from WTO.

Further, while these far-reaching agreements have substantially increased U.S. trade agreement rights, they have also increased U.S. trade agreement obligations to other nations. As a result, the agencies' dispute settlement caseload has continued to grow. This situation has affected USTR's workload in particular because the agency is responsible for advocating and defending U.S. trade agreement rights and obligations within North American Free Trade Agreement (NAFTA) and WTO. The number of active cases involving the United States has increased from 39 in 2000 to 46 in 2002 even as the number of resolved cases has grown. Moreover, a growing focus of U.S. dispute settlement efforts is responding to cases brought against the United States by other nations. More than half of these cases have focused on U.S. use of trade remedy laws, particularly U.S. actions taken against steel imports. USTR relies on support from Commerce for these cases. According to Commerce officials, WTO dispute settlement cases are especially time consuming because of the tight deadlines and numerous filings required. Figure 7 depicts the status of WTO dispute settlement cases involving the United States in 2000 and 2002.

**Figure 7: WTO Dispute Settlement Cases Involving the United States, 2000 and 2002**

100 Number of dispute settlement cases



Source: USTR data.

U.S. Trade Agencies Have Recently Increased  
Staffing in Key Areas, but Impact of Additions Is Uncertain

Human resources are the single most important asset of the agencies responsible for monitoring and enforcing the growing volume of trade agreements. This work requires country, industry, and functional expertise, and a mixture of economic, technical, and legal analysis. In March 2000, we reported that the three key trade agencies' human capital capabilities had not kept pace with their increased monitoring and enforcement workload. Specifically, staff levels at the three key agencies were flat or declining.

Since our March 2000 report, USTR, the Foreign Agricultural Service (FAS), and two of the three divisions in Commerce's International Trade Administration have received significant increases in funding for staff to monitor and enforce trade agreements. However, due to the recent nature of the increases, we believe it is too early to determine fully whether these additions have been effective in resolving the human capital issues that we cited in our report.

These increases involved the following groups:

- In 2001, USTR received funding to add 25 new positions, which increased the agency's total FTE staff level to 203. All 25 positions have been filled. Thirteen of the new positions were in the area of trade enforcement, 11 were in negotiations, and one was administrative.

- In 2001, Commerce's ITA received increased funding for staff, but not all of ITA's divisions with monitoring and enforcement responsibilities have actually added resources.
  - ITA's Market Access and Compliance (MAC) Division—one of ITA's two main divisions with export-related trade agreement monitoring responsibilities—was funded for an additional 35 positions. As of the end of 2001, MAC had filled 31 of these authorized positions. MAC's new positions filled in 2001 included nine staff to work specifically on China issues and four to work on general issues involving compliance with trade agreement provisions.
  - ITA's Trade Development (TD) Division, which has responsibility for monitoring export-related trade agreements in sectors such as automobiles, aerospace, and telecommunications, was funded for one additional position in 2001. However, the division's actual staff levels declined from 380 to 363 that year. Staff levels at Commerce's Office of Automotive Affairs have remained flat at 16 full-time employees for the past 4 years.
  - ITA's Import Administration Division hired 27 additional staff in 2001. This division administers U.S. trade laws on antidumping and countervailing duties and monitors enforcement of sector-specific agreements governing U.S. imports. Most of the new positions were for enforcing subsidies agreements and monitoring China's and Japan's compliance with trade agreements.
- The FAS, which handles most of Agriculture's trade policy and promotion responsibilities, was funded for a total of 18 new staff years in 2001 and 2002. This increase in staff was for activities related to monitoring countries' technical trade barriers and foreign regulatory measures regarding imports of products with a biotechnology component.

With increased staff levels in 2001, officials at the three agencies generally believe they now have adequate capacity to monitor and enforce trade agreements. However, we believe it is too early to tell if the new staff will enable the agencies to fulfill their mission of monitoring and enforcing trade agreements. One reason is that most of the new staff have been on board for a year or less, so the impact of these new additions is uncertain. Another reason it may be difficult to judge the effectiveness of the staff increases is the continuing growth in the agencies' workload, which could potentially cause a shift in resources intended for trade compliance activities. According to USTR's 2003 budget justification, never in history have so many countries participated in global trade negotiations.<sup>13</sup>

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<sup>13</sup> The WTO Ministerial Declaration that launched new multilateral trade negotiations in 2002 sets an ambitious timetable, with the negotiations scheduled for completion by 2005. At the same time, USTR is pursuing another major negotiating initiative, the Free Trade Area of the Americas (FTAA), which would establish the largest free trade zone in the world. In addition to these multilateral negotiations, the United States intends to complete bilateral free trade agreements with Chile and Singapore this year. Further, the United States is exploring a free trade agreement with five countries of Central America.

To handle the expected increase in the negotiations workload, USTR is requesting authority for six new negotiator positions. The MAC unit in ITA, which will support USTR in all the negotiations, is requesting 33 new FTEs in its 2003 budget, 21 of whom will provide support for WTO and FTAA negotiations. Without additional resources for negotiations, agency officials told us they may have to shift resources away from trade compliance to meet the increased workload in conducting negotiations.

### Past Workload Imbalances Hindered Trade Agencies' Ability to Fulfill Their Missions

Past staffing and workload imbalances hindered the three trade agencies' abilities to fulfill their trade monitoring and enforcement missions. As we reported in March 2000, agency officials stated that gaps in staff expertise had hindered their efforts to analyze and respond to compliance problems. In addition, officials at all three agencies said that steady declines in staff resources had limited the level of support they provide to each other. Finally, we also cited challenges at the three agencies in coordinating their efforts with the private sector.

While trade agreements in the past focused primarily on tariffs, they now address a broader range of trade issues, such as product standards and food safety measures, making the task of monitoring and enforcing trade agreements more challenging. Given these developments, agencies need staff with the ability to perform a mixture of economic, technical, and legal analysis. However, most of the agencies we examined in our 2000 report did not have the capability to do all types of analysis themselves, and they required input from other offices and agencies.

As we reported in March 2000, insufficient staff resources limited the agencies' ability to provide each other the needed input and support. USTR, in particular, requires support from other agencies, as it was created to coordinate federal trade efforts; its staff was not intended to have expertise on every area covered by trade agreements. USTR officials as well as those at Commerce and Agriculture often stated that they had difficulty obtaining needed analytical support from offices within their own agency or from other agencies.<sup>14</sup> USTR and Agriculture officials also reported that insufficient staff at other agencies limited the extent to which these agencies had supported their monitoring and enforcement efforts. Since our March 2000 report, however, USTR officials noted that the level of support they receive from other agencies, particularly Commerce, has improved as a result of increased staff levels.

In our 2000 report, we also found that the three agencies identified challenges in coordinating with the private sector. We found that the agencies were not always able to obtain comprehensive private sector input and unified positions on pending trade issues. As a result, we recommended that USTR assess whether existing mechanisms for obtaining private sector input are adequate. USTR did undertake a self-assessment on one aspect of this issue in 2000 that

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<sup>14</sup> Although USTR is the lead trade agency and was intended to coordinate federal trade efforts, the multiple agencies responsible for monitoring and helping USTR enforce trade agreements still independently estimate their staffing and budget needs, and USTR has no input into their staffing or budget requests. However, officials are making efforts at the operational level within the agencies to coordinate on staffing needs. For example, Commerce and State co-chair an Interagency Compliance Coordination Committee that is focused on determining whether the trade-related agencies have adequate staff with the right skills working on trade agreement compliance issues at U.S. posts overseas and at headquarters in Washington, D.C.

resulted in a January 19, 2001, report that recommended some improvements. The current administration is now considering these and other recommendations for improvement. At the request of the Senate Finance Committee's ranking minority member, we are currently studying whether the statutorily mandated private sector advisory committee system that USTR chairs adequately supports U.S. trade policy.

### Recruiting and Retention Issues Present Other Challenges

There are several other human capital challenges facing the agencies that monitor and enforce trade agreements. In particular, the need for specialized knowledge and demand for individuals with experience in trade compliance and litigation creates challenges in recruiting and retaining staff.

While staff levels for monitoring and enforcing trade agreements have increased at the three key agencies, officials noted that the hiring process has often been slow. For example, at USTR it took most of 2001 to hire the 25 new staff that the agency had been authorized at the beginning of the year. Factors that contributed to the hiring delays included difficulties attracting individuals with the requisite skills and experience. In addition, the agency needed to hire specialists for many of the positions, including economists, attorneys with litigation experience, and individuals with industry and regional expertise. Because of its small size, USTR does not have a formal recruitment program. The agency reports attracting numerous applicants for each position. However, finding individuals with specialized experience can be difficult. FAS officials also told us that in some cases it took up to a year to hire staff because of difficulty finding applicants with the needed technical skills. Commerce's ITA has a formal recruitment program and did not experience difficulty attracting applicants. In addition, in 2001 they began using OPM's Outstanding Scholarship Program as a recruitment tool. However, ITA officials noted that since September 11, there have been significant delays in obtaining security clearances for staff hired to fill trade compliance positions overseas, which in turn has delayed bringing the staff on board.

Turnover at the three trade agencies has remained high, particularly at USTR and Commerce. For example, while comparisons must be made with caution, USTR's attrition rate was almost 17 percent in 2001, more than triple the government wide rate of 5.4 percent that year. Attrition has also been relatively high at Commerce's Import Administration Division, reaching 11 percent in 2001, or more than double the government wide rate.

Attrition at both USTR and Commerce's Import Administration Division historically has been high. Reasons include the intensity of work and the long hours required to handle caseloads. In addition, as with the SEC, staff often leave government as they receive lucrative offers from the private sector due to their highly technical areas of expertise, such as experience with trade litigation. USTR has devoted additional resources to training and performance bonuses in an effort to improve retention. Because persons leaving USTR for jobs in the private sector often receive offers that are \$50,000 to \$100,000 higher than their government salary, USTR has not pursued retention bonuses as a strategy for stemming attrition. Commerce's ITA has also taken a number of steps to increase retention, including expanding their award and training programs and

conducting surveys on employee satisfaction. The agency is working to have career ladders for non-supervisory personnel extend more routinely to the GS-14 level. For example, Import Administration Division officials worked with ITA management to retain current staff through flexibility in using promotions, such as upgrading certain specialized positions based on increased duties and responsibilities. According to ITA's deputy undersecretary, the two biggest human capital challenges facing ITA are turnover rates and succession planning. He noted that almost 60 percent of ITA's senior executive service will be eligible to retire by 2007.

## **Concluding Remarks**

We will end as we began, serious human capital shortfalls are eroding the capacity of many agencies, and threatening the ability of others, to economically, efficiently, and effectively perform their missions. Many of the challenges that we discussed today are not unique to SEC or the key trade agencies but reflect governmentwide issues this subcommittee has been grappling with for years. The federal government's human capital weaknesses did not emerge overnight and will not be quickly or easily addressed. Committed, sustained inspired leadership and persistent attention on the behalf of all interested parties will be essential if lasting changes are to be made and the challenges we face successfully addressed. Although we are seeing positive changes and developments overall, including some positive steps at the agencies we discussed here today, there continues to be much work to be done.

As the Comptroller General recently testified before this subcommittee, the proposed Federal Human Capital Act of 2001 (S. 1603) represents an important next step to helping agencies address their human capital management challenges.<sup>15</sup> In that testimony, we also discussed our model of strategic human capital management, released last month as an exposure draft to assist in transforming the human capital cultures of federal agencies. These important new developments have important implications for the agencies discussed today.<sup>16</sup>

Thank you again for your continuing attention to human capital reform. The leadership shown by this subcommittee, by holding this and related hearings and in its oversight generally, has both helped to create and increase the needed momentum for change and highlight the need for, and direction of, possible solutions. We would be pleased to respond to any questions you or other Members of the subcommittee may have.

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<sup>15</sup> U.S. General Accounting Office, *Managing for Results: Building on the Momentum for Strategic Human Capital Reform*, GAO-02-528T (Washington, D.C.: Mar. 18, 2002).

<sup>16</sup> U.S. General Accounting Office, *A Model of Strategic Human Capital Management, Exposure Draft*, GAO-02-373SP (Washington, D.C.: Mar. 2002).

## **Contacts and Acknowledgments**

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